INTERNAL REVENUE SERVICE
TREASURY
Director, Exempt Organizations

DEPARTMENT OF THE

1100 Commerce Street Dallas, Texas 75242

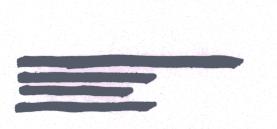
Employer Lientification Number:

Terson To Contact:

Contact Telephone Number:

In Response, Refer to:

Date: APR 2 4 2900



CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(12) of the Internal Revenue Code.

Your purpose is the operation, development and maintenance of a cooperative water company to the ultimate mutual benefit of the owners of property in said parcels legally described in your Articles of Incorporation. The Articles of Incorporation contain provisions for limitation of activities and dissolution as contained in language required under section 501(c)(3). Thus, dissolution of assets would be to an entity exempt under section 501(c)(3) or for purposes exempt under section 501(c)(3). You provided Articles of Amendment and Restated Articles of Incorporation but they did not have evidence of State filing, and based on what you obtained from the State, have never lien filed with the State.

Your by-laws indicate membership is restricted to legal owners or land title-holders as identified in your Articles of Incorporation. They further state that all members have equal rights and that membership terminates upon a qualified member becoming divested of title-interest or rights to land. Currently, families use your water service and pay a flat monthly fee. Water rules voted on, indicate that there will be a monthly minimum charge and a per gallon rate for all monthly consumption in excess of the average monthly residential level of consumption.

Your application indicated that upon dissolution any funds in your checking account would be returned to members who sent in the payments. You also indicated the water well would be returned to the current owner.



In a response vou stated that disposition of assets upon dissolution is to be determed by at all VI of your Articles of Incorporation, or the directors and members at that time. Further, you stated that you desire to continue to vest the interest in the land and to consider all rights and interests terminated when the owner of the land sells.

Section 501(c)(12) of the Internal Revenue Code provides for exemption from Federal income tax of mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations, if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Revenue Ruling 72-36, 1972-1 CB 151, indicates the following:

The rights and interests of the members in the savings of an organization should be determined in proportion to their business with the organization. The interests of members in the savings of the organization may be determined in proportion to either the value or the quantity of the services purchased from the organization, provided such basis is realistic in terms of actual cost of the services to the organization.

To maintain its mutual or cooperative character an organization must keep such records as are necessary to determine, at any time, each member's rights and interest in the assets of the organization.

In the case of forfeiture of a former member's rights and interest upon withdrawal or termination, the organization has not operated on a mutual or cooperative basis and is therefore not exempt.

When dissolving an organization having gains from the sale of an appreciated asset should distribute the gains to all persons who were members during the period in which the asset was owned by the organization. The distributions to members and former members must be in proportion to the amount of business done by such members during that period, insofar as is practicable.

You do not comply with the requirements of sections 501(c)(12) as identified in Revenue Ruling 72-36 since former members forfeit their rights and interests in assets when they transfer their property. Also, your dissolution to a section 501(c)(3) entity or to your current members only would be inconsistent with Revenue Ruling 72-36.

You have indicated you do not want to change your method of operation to comply with Revenue Ruling 72-36. Therefore, you do not qualify for exemption under section 501(c)(12) of the Internal Revenue Code.

Accordingly, you are not exempt and should file Form 1120.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

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If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return form 6018 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Steven J. Briller
Steven T. Miller

Director, Exempt Organizations

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Enclosures:

Form 6018 Return Envelope